ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers	)	CCB/CPD File No. 98-63

COMMENTS OF U S WEST, INC.

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October 29, 1999

SUMMARY

U S WEST supports the proposals contained in the FNPRM insofar as they are deregulatory and grant additional flexibility to LECs to respond to market forces. In particular, the Commission should permit LECs to deaverage switched access rate elements in the common line and traffic-sensitive baskets without requiring a competition or cost showing. Giving LECs this flexibility is essential to the development of competition for access services and to avoiding competitive distortions once UNE rates are deaveraged.

However, U S WEST does not support those proposals that, rather than giving LECs flexibility to respond to market forces, *mandate* specific and significant changes in access charge rate structures. Thus, the Commission should not require LECs to deaverage based on a one-size-fits-all regulatory schedule. Likewise, the Commission should not require LECs to adopt a capacity-based rate structure for local switching. A capacity-based approach would increase the cost of LECs' tracking and billing systems by requiring them to accommodate capacity and MOU data simultaneously. A capacity-based approach also would pose a number of practical difficulties. Most significantly, such an approach could create arbitrage opportunities, and in turn distort traffic patterns in ways the network is not equipped to handle, by enabling IXCs to lower their local switching charges simply by routing more of their traffic through the tandem. And in any event, capacity-based rates do not necessarily reflect the way local switching costs are incurred any better than the current structure.

The Commission also should not mandate arbitrary reductions in LEC access revenues. In particular, there is no economic basis for adopting a q factor in connection with a switch to capacity-based pricing. While the Commission analogizes a q factor to the existing g factor in the common line basket, the two situations are entirely different, and the reasons for

adopting a g factor in the common line basket simply do not apply to local switching. Likewise, the traffic-sensitive and trunking baskets should not be reinitialized as if they had contained a q factor since 1991; since there is no economic basis for the q factor in the first place, there was no reason to impose it in the past and the price cap indices for those two baskets are not inflated.

U S WEST supports the proposal in the FNPRM to reorganize the price cap baskets. Placing dedicated and shared components into distinct baskets would greatly simplify the price cap calculations that LECs and the Commission must perform for each tariff filing.

Finally, the Commission should not permit IXCs to refuse to terminate calls with particular CLECs. Allowing IXCs such an option would adversely affect consumers, who would not be able to complete calls to CLECs with whom their IXC chooses not to deal. Rather, the Commission should make clear that IXCs may bring complaints against CLECs that may be charging unreasonable rates for terminating access and that the Commission will resolve such complaints expeditiously. In any event, the burden of mediating access charge disputes between IXCs and CLECs should not fall to incumbent LECs.

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COMMENTS OF U S WEST, INC.

U S WEST, Inc. ("U S WEST") submits these comments in response to the Commission's Further Notice of Proposed Rulemaking ("FNPRM") in the above captioned proceedings.[1/] U S WEST supports the proposals in the FNPRM insofar as they are deregulatory and aimed at increasing the flexibility of LECs to respond to market forces. In particular, *allowing* LECs to deaverage switched access rates and to determine whether or not a capacity-based rate structure would be more efficient for them would contribute to a more economically rational and ultimately more competitive market for switched access.

At the same time, the Commission should avoid preempting market forces by imposing rate structure changes through regulatory mandates or by ordering arbitrary rate reductions. Specifically, mandating (as opposed to permitting) a capacity-based rate structure for switching would cause LECs to incur additional expenses and raise significant arbitrage

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1/ *Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, CC Docket Nos. 96-262, 94-1 and CCB/CPD File No. 98-63, FCC 99-206 (rel. Aug. 27, 1999) ¶¶ 190-257 ("FNPRM" or "Order").

problems, all in exchange for what very well could be zero gains in efficiency. Likewise, ordering reductions in switched access rates through a "q" factor or other manipulations of the price cap formula makes no sense from an economic perspective and would undermine the efficient incentives that the price cap regime is intended to foster.

I. THE COMMISSION SHOULD GIVE PRICE CAP LECS THE FLEXIBILITY TO DEAVERAGE ACCESS RATE ELEMENTS IN THE COMMON LINE AND TRAFFIC-SENSITIVE BASKETS WITHOUT REQUIRING A BURDENSOME COMPETITION OR COST SHOWING.

In the Order released with the FNPRM, the Commission granted price cap LECs the flexibility to deaverage access rates in the trunking basket without having to make a burdensome showing concerning either the extent of competition or the cost characteristics of different geographic zones.[2/] For identical reasons, the Commission should permit the same flexibility for elements in the common line and traffic-sensitive baskets, using its rules for the trunking basket as a model.

A. The Commission Should Permit Deaveraging in the Common Line and Traffic-Sensitive Baskets Subject to Simple Safeguards Rather Than Impose Complicated or Burdensome Preconditions.

As the Commission has observed, deaveraging "enhances the efficiency of the market . . . by allowing prices to be tailored more easily and accurately to reflect costs and, therefore, promotes competition in both urban and rural areas."[3/] Geographically averaged rates can distort competition:

> [A]veraging across large geographic areas distorts the operation of markets in high-cost areas because it requires incumbent LECs to

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2/ Order ¶¶ 58-66.

3/ *Id.* ¶ 59.

> offer services in those areas at prices substantially lower than their costs of providing those services. Prices that are below cost reduce the incentives for entry by firms that could provide the services as efficiently, or more efficiently, than the incumbent LEC. Similarly, discrepancies between price and cost may create incentives for carriers to enter low-cost areas even if their cost of providing service is actually higher than that of the incumbent LEC.[4/]

These economic and procompetitive rationales for deaveraging apply just as readily to rates in the common line and traffic-sensitive baskets as they do to rates in the trunking basket.

As in the case of the trunking basket, the Commission should allow price cap LECs to define the number and geographic scope of pricing zones for the common line and traffic-sensitive baskets, subject only to simple and easily verified limitations. For example, the Commission could provide again that each zone other than the highest-cost zone must account for at least 15 percent of the LEC's study area revenues in the relevant basket;[5/] that there be no more than seven zones per study area;[6/] and that annual price increases within each zone be limited to 15 percent.[7/] The Commission should *not* prescribe rigid or complex standards to govern how zones may be defined, because, as the Commission has acknowledged, "if we grant incumbent LECs practical flexibility to choose the number of zones and the criteria for

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4/ *Id.* ¶ 61.

5/ *See id.* ¶ 59.

6/ *See id.* ¶ 62.

7/ *See id.* ¶ 63.

establishing zone boundaries, they are more likely to establish reasonable and efficient pricing zones than if their flexibility is more constrained."[8/]

Nor should the Commission require a price cap LEC to make a showing concerning the cost characteristics of the pricing zones it proposes. Cost showings can be complicated and burdensome endeavors, and the experience with density pricing zones has demonstrated that carriers will not take full advantage of deaveraging if the rules make it burdensome to do so. Under the density zone pricing rules, an incumbent LEC was required to show that the zones it proposed reflected cost characteristics, and the incumbent was subject to increased scrutiny if it proposed more than three zones in a study area.[9/] As a result, LECs did not even attempt to adopt more than three zones,[10/] and multiple commenters in this proceeding have observed that the density pricing provisions were significantly underutilized.[11/] As the Commission correctly suggested, "lack of flexibility in our density zone pricing rules may be responsible for incumbent LECs' current failures to take full advantage of such opportunities."[12/]

For similar reasons, the Commission should not require a competitive showing as a precondition to deaveraging in the common line and traffic-sensitive baskets. There simply is no need for such an additional layer of regulatory red tape. First, even without regulatory interference, a LEC is unlikely to deaverage its rates in a given study area until it experiences

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8/ *Id.* ¶ 61.

9/ *See id.* ¶¶ 58, 60.

10/ *See id.* ¶ 60 n.161.

11/ *See id.* ¶ 66.

12/ *Id.*

significant competitive pressure there. Deaveraging has no impact on the total amount of revenues a LEC collects, so from the LEC's perspective the entire point of deaveraging is to establish prices that will better enable it to meet competition. In the absence of competition, there is no incentive for the LEC to deaverage.

Furthermore, regulatory safeguards such as minimum revenue requirements for pricing zones and limits on price increases should be more than sufficient to eliminate any perceived risks. Just as in the trunking basket context, a requirement that each zone account for a specified percentage of study area revenues "should deter incumbent LECs from establishing rates for low-cost zones that are so low as to enable them to raise rates to unreasonably high levels in high-cost zones" and a limit on price increases within zones should "prevent the disruptive effects of rapid and unexpected price increases."[13/] Given these sensible safeguards, allowing deaveraging without a competitive showing should not pose any dangers. And as a final backstop, any party that believes a LEC's pricing zone plan is unreasonable would be free to challenge the plan as part of the tariff approval process or through a formal section 208 complaint.[14/]

If the Commission nonetheless decides to require a competitive showing, it should be sure to make the competitive prerequisites simple, clear, and relatively easy to satisfy. If the rules are complicated or require a burdensome factual showing, the deaveraging option will be underutilized and the economic benefits associated with deaveraging will be seriously jeopardized.

13/ *Id.* ¶ 63.

14/ *See id.* ¶ 65.

Moreover, LECs must in any event be permitted to deaverage switched access rates in a study area once UNE rates in that study area are deaveraged.[15/] When UNE rates in a study area are deaveraged, UNE prices in low-cost areas will fall, enabling competitors in those areas to offer service using the LEC's facilities at prices significantly lower than the averaged prices the LEC has been required to charge. If the LEC is not permitted to deaverage, it will not be able to meet this competition. As competitive providers take advantage of this easy arbitrage opportunity, the LEC, with its averaged rates, will rapidly lose customers in low-cost areas (where the averaged rates are significantly higher than costs) while continuing to serve its customers in high-cost areas (where averaged rates are significantly below costs). The predictable end result of this skewed regulatory scheme will be not only underrecovery by the LEC but denial of competitive benefits to consumers. To prevent such a scenario, the Commission should make clear that, whatever conditions or prerequisites it might impose on the deaveraging of elements in the common line and traffic-sensitive baskets, the deaveraging of UNE rates in a study area immediately triggers the LEC's right to implement such deaveraging there.

15/ The deaveraging of UNE rates is not an idle or distant prospect. The Commission has issued a rule requiring states to deaverage UNE rates geographically by establishing at least three separate pricing zones per state. *See* 47 C.F.R. § 51.507(f). The Commission has stayed the effectiveness of the rule, but on October 21, 1999, the Commission announced that the stay will be lifted six months from the release of the text of an October 21 universal service decision, which is expected any day now. *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* Stay Order, 14 FCC Rcd 8300 (1999); FCC Reforms High-Cost Support to Ensure the Preservation and Advancement of Universal Service, FCC News Release, Oct. 21, 1999. Therefore, state-by-state UNE deaveraging is imminent.

B. The Commission Should Allow Market Forces To Govern the Pace of Deaveraging Rather Than Impose a Regulatory Mandate.

While deaveraging of elements in the common line and traffic-sensitive baskets offers significant potential benefits, the Commission should rely on market forces to dictate the pace of deaveraging rather than impose a regulatory mandate. As described above, market forces naturally will lead LECs to deaverage on an appropriate timeframe, taking into consideration the particular circumstances of each study area. The Commission should not overregulate the transition by imposing a one-size-fits-all schedule or set of conditions. Indeed, making the transition hinge on a set of specified conditions would encumber the process with unnecessary administrative proceedings to determine when and whether the conditions have been met and would likely result in legal challenges to the Commission's initial determinations. Giving LECs the necessary flexibility and allowing market forces to work would be far simpler and more efficient.

Complications associated with the deaveraging of common line basket rates also argue for flexibility in the timing of deaveraging. Rate deaveraging increases cost recovery in high-cost areas. However, two of the main charges in the common line basket, the subscriber line charge ("SLC") and the presubscribed interexchange carrier charge ("PICC"), are subject to caps. If these rates are at or near their current caps in a particular high-cost area, and if the caps are not lifted, the SLC and PICC will not be able to bear the additional cost recovery associated with deaveraging. That means that some or all of the necessary additional cost recovery in high-cost areas will fall on the per-minute carrier common line ("CCL") charge, which would have to

rise accordingly. Yet, as the Commission has noted, per-minute recovery of common line costs is inefficient and inappropriately discourages use of the common line.[16/]

This problem will recede over time as the SLC and PICC caps increase, permitting more and more of the additional high-cost recovery to be recovered on a flat-rated basis. In deciding when to adopt deaveraging in a given study area, LECs should be given the flexibility to take account of the extent to which SLC and PICC caps in the particular area will or will not yet permit additional flat-rated recovery in high-cost areas, and to weigh this factor against the pace at which developing competition is creating a real, market-driven need for deaveraging. A LEC's market-driven business analyses of these factors on a study area-by-study area basis will produce more efficient results than a one-size-fits-all rule or cumbersome regulatory proceedings to investigate conditions in each study area.

II. THE COMMISSION SHOULD NOT MANDATE A CAPACITY-BASED RATE STRUCTURE FOR LOCAL SWITCHING.

The Commission requests comment on replacing the existing per-minute or per-call rate structure for local switching with a "capacity-based" rate structure under which an IXC's switching charges would be based on the number of trunks the IXC has connected to each end office switch.[17/] Implementing such a rate structure would impose significant additional costs on price cap LECs and give rise to serious arbitrage issues. Moreover, the proposed rate structure would not necessarily result in any significant improvement in the economic rationality of the rate system. Accordingly, the Commission should not mandate a capacity-based rate structure

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16/ *Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982, 16008 ¶ 69 (1997).

17/ FNPRM ¶ 207.

for local switching. At most, the Commission should adopt a permissive rule that would allow a LEC to adopt the new structure whenever the LEC determines that such a structure offers efficiency gains in excess of the costs.

A. A Capacity-Based Rate Structure Would Burden LECs with Increased Call Tracking and Billing Costs.

Implementing a capacity-based rate structure for local switching would impose substantial additional costs on price cap LECs. Specifically, LECs would have to add a new layer of complexity to their call tracking and billing systems, because those systems would have to accommodate the new capacity data while still continuing to monitor, record, and in some cases bill on the basis of minutes of use ("MOU") data. All of these functions would have to be retained even if the Commission were to require a capacity-based rate structure for local switching, because MOU data will remain relevant for a number of purposes. For example, pursuant to Part 36 of the Commission's rules, the jurisdictional separations process for switching costs is based on the relationship of interstate MOU to total recorded MOU. The CCL charge depends on MOU. Common transport is and should continue to be billed on a per-mile, per-MOU basis. And the MECAB/MECOD industry guidelines that govern meet point billing arrangements call for payments based in part on MOU; these guidelines reflect industry consensus and would take substantial time to revise.

Thus, implementing a capacity-based rate structure would require LECs to maintain all existing MOU-oriented systems while at the same time adding new tracking and billing capabilities to permit capacity-based billing for the local switching element. The additional level of complexity would entail significant up-front reprogramming costs and would

increase the ongoing expenses associated with running and maintaining call tracking and billing systems.

B. A Capacity-Based Rate Structure Would Raise Arbitrage Issues and Other Practical Difficulties.

A capacity-based rate structure for local switching also could create a serious arbitrage problem. Under the current rate structure, IXCs pay for local switching based on the total MOU of the switch, so their choice of direct trunked or tandem switched transport does not affect their local switching charges. Larger IXCs generally find direct trunked transport to be more economical, so they purchase enough dedicated trunks per switch to handle the bulk of their traffic and use tandem switched transport only for occasional overflow. But if local switching charges were based on the number of trunks an IXC has purchased, then an IXC would have a heightened incentive to purchase fewer dedicated trunks and to allow more of its traffic to overflow to the tandem. This is essentially a regulatory arbitrage issue: An IXC could save on local switching charges without reducing its level of traffic transiting the local switch, simply by choosing to use tandem switched instead of dedicated transport. The resulting increase in tandem switched traffic volumes could swamp existing tandem switching facilities and require LECs to make substantial additional investments to augment their tandem switching capacity.

This arbitrage opportunity and the resulting distortion of traffic patterns could be eliminated if a carrier purchasing tandem switched transport were assessed a local switching charge equivalent to that which applies to direct trunked traffic. However, it is far from clear that such equivalency could be achieved. There is no apparent way to apply a capacity-based rate structure to traffic that uses shared transport trunks rather than dedicated ones; a per-trunk local

switching charge does not work when IXCs do not purchase their own trunks into the local switch. And if the local switching charge applicable to tandem trunked traffic were based on MOU, then there would be no valid way to compare it with the trunk-based charge applicable to direct trunked traffic — one would be comparing apples and oranges.

One possibility might be to assess a per-trunk local switching charge based on an IXC's dedicated trunks between the *tandem* and its point of presence, on the theory that traffic sent through the tandem eventually reaches the local switch and that an IXC's trunks into the tandem therefore are a good proxy for the IXC's peak usage of local switching capacity. The problem with this approach is that tandem routing is used for many types of calls that do *not* use the LEC's local switching — namely, calls that originate or terminate with customers served by wireless providers, CLECs, and independent LECs. Thus, an IXC's peak capacity usage of a LEC's tandem switching is not reliable as a proxy for its peak capacity usage of the LEC's local switching. Indeed, since a significant (and growing, due to the continuing proliferation of wireless providers and CLECs) proportion of tandem routed traffic does not in fact use the LEC's local switching, applying the same per-trunk local switching charge to dedicated trunks into the tandem as to dedicated trunks into the local switch would cause tandem trunked traffic to be *overcharged* for local switching: IXCs would pay for more local switching capacity than they actually use.[18/]

Another potential option would be to declare arbitrarily that a specified quantity of MOU of tandem trunked traffic into a local switch will be treated as the purchase of a trunk and

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[18/] An additional problem is that, if local switching rates were deaveraged, it would in many cases be difficult to determine which rate to apply to charges assessed based on tandem usage, because a particular tandem switch could serve local switches in different pricing zones.

charged accordingly. However, for purposes of this latter option, one would have to focus on MOU at peak usage times rather than total MOU, because, on the theory underlying capacity-based switching, peak usage drives switching costs and non-peak usage is essentially irrelevant.[19/] The Commission already has concluded that it is extremely difficult to determine peak and off-peak hours with any degree of certainty.[20/]

Because equalizing the local switching charges applicable to direct trunked and tandem trunked transport would be difficult if not impossible to do with any precision, a capacity-based rate structure would need to be accompanied by a safeguard mechanism to ensure that IXCs are not artificially induced to order fewer dedicated trunks and instead route more traffic as overflow to the tandem. There is no real prospect of discouraging such arbitrage behavior by imposing a special surcharge on overflow tandem traffic because, as a technical matter, the recording equipment in the switch that creates the billing records cannot distinguish between overflow traffic and the ordinary tandem-routed traffic of small IXCs. Therefore, the only option would be to adopt rules that would permit a LEC, upon a showing under objective criteria that an IXC is underordering trunks, to require the IXC to increase its trunk purchases. For example, a LEC should be permitted to require additional trunk purchases where an IXC's average busy hour overflow traffic exceeds the capacity of a DS-1 over a period of 20 business days.[21/] (Interconnection agreements generally contain similar provisions, permitting the LEC to

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19/ *See* FNPRM ¶ 211.

20/ *See id.*

21/ This criterion mirrors the industry's generally accepted engineering standards for efficient trunk deployment, under which an additional DS-1 of capacity results in the deployment (continued...)

add trunks on behalf of a CLEC as the CLEC's capacity usage increases.) Such a safeguard mechanism would be essential to minimize the arbitrage risks of a capacity-based rate structure.

Meet point billing arrangements present a separate practical difficulty. If price cap LECs implement a capacity-based rate structure but other LECs continue to charge for switching on an MOU basis, it is not clear how to handle the situation in which a price cap LEC and a non-price cap LEC jointly provide access under a meet point billing arrangement. Among other problems, the billing system of the non-price cap LEC is unlikely to be equipped to handle capacity-based charges.

The split billing of local switching rate elements for IXC resellers poses a similar problem. Many IXCs sell capacity to third party carriers that do not own their own facilities. Under the current MOU rate structure, U S WEST is able to bill either the facilities-based IXC or the reseller. This is possible only because AMA switch recordings capture the necessary carrier information for each individual call. However, under a capacity-based rate structure, a LEC would have no way to perform comparable split billing of per-trunk switching charges, because the LEC would have no basis to determine what portion of a trunk should be attributed to the reseller. Therefore, such charges could be assessed on the facilities-based IXC only. The IXC's recovery of those charges from the reseller would have to be a matter of private contractual agreement between parties.

21/ (...continued)
of an additional trunk. The engineering standards also use 20 business days as the monitoring period for purposes of trunk group forecasting and servicing. *See* Bellcore, *Trunk Traffic Engineering Concepts and Applications*, SR-TAP-00191 (Dec. 2, 1989) at 6-15.

C. A Capacity-Based Rate Structure Would Not Necessarily Result in Any Improvement in the Economic Performance of the Rate System.

In any event, a capacity-based rate structure would not necessarily yield any significant economic benefit. The Commission's goal in proposing a capacity-based structure is to ensure that the rate structure for local switching reflects the manner in which price cap LECs incur local switching costs.[22/] The Commission speculates that switching costs are driven by peak demand, but acknowledges that determining peak and off-peak times is extremely difficult "due to geographic, user-type, and service considerations" and because peak demand times can shift as a result of changes in pricing plans.[23/] The Commission suggests that capacity-based pricing may reflect the peak-driven nature of switching charges without the difficulties raised by "determining peak and off-peak hours."[24/]

The Commission's unstated but crucial assumption is that the number of trunks that an IXC purchases reflects the IXC's capacity usage at times of peak demand. This makes some sense; after all, an IXC likely purchases trunks based on the maximum amount of traffic it expects to carry at any one time. If an IXC purchases three trunks into a particular switch, one would expect the IXC to have approximately three trunks' worth of traffic into that switch at its time of peak demand, and less at all other times.

However, in purchasing dedicated trunks, an IXC will focus exclusively on the expected demand patterns of its own customers. Thus, the number of trunks an IXC purchases is

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22/ *See* FNPRM ¶ 211.

23/ *Id.*

24/ *Id.*

a reflection only of its expected traffic volumes during *its own* time of peak demand. There is no guarantee that peak demand time for one IXC will be identical to the peak demand time for other IXCs, or — most importantly for present purposes — to the peak demand time for the *switch as a whole*. After all, different IXCs may serve different mixes of customer types, and different customer types can have strikingly different usage patterns.[25/] Differences in pricing plans also can cause differences in usage patterns, and the Commission expressly stated its expectation that a capacity-based rate structure would create an incentive for IXCs to develop more off-peak pricing plans. Moreover, peak demand times for the switch depend on local as well as long distance calling patterns, and peak time for local calls could be different from peak times for long distance. In short, there is no reason to assume that an individual IXC's peak demand time for a particular switch will be identical to the peak demand time for the switch as a whole.

Therefore, there is no necessary relationship between the number of trunks that a particular IXC purchases and that IXC's capacity usage at times of peak demand for the switch. And to the extent that switching costs are driven by peak demand, it is peak demand *for the switch* that is relevant, not peak demand for any particular IXC. Thus, the capacity-based rate structure the Commission has proposed would not result in anything close to a perfect match between rates and cost causation. Indeed, there is no reason to believe that the proposed rate structure would be any significant improvement over the current one.

25/ *See id.*

III. THE COMMISSION SHOULD NOT MANIPULATE THE PRICE CAP FORMULA IN AN ARBITRARY ATTEMPT TO REDUCE SWITCHED ACCESS AND COMMON LINE RATES.

In 1991, the Commission instituted price cap regulation of LECs because price caps "affirmatively encourage[] innovation by offering [LECs] the opportunity to retain some of the reward of successful innovation."[26/] Several times since the institution of price cap regulation, the Commission has dampened this incentive by manipulating the price cap formulas to reduce substantially the revenues that LECs are permitted to retain. The Commission proposes to do it again here. First, the Commission proposes to introduce a "q" factor into the traffic-sensitive and trunking basket price cap indices ("PCIs") that would eliminate or reduce a LEC's ability to recover the very real costs associated with increases in switching volumes.[27/] Second, the Commission proposes yet another "one-time" reduction in the traffic-sensitive and trunking basket PCIs to reset those PCIs as if there had been a q factor in them from 1991 to the present.[28/] And third, the Commission proposes to increase the "g/2" factor in the common line PCI basket.[29/] The Commission should not adopt any of these proposals.

A. There Is No Economic Justification for Adopting a q Factor, Because Increases in Switching Volume Entail Real Economic Costs.

The Commission suggests that, if it adopts a capacity-based rate structure for switching, it should include a "q factor" similar to the g factor it has incorporated into the

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26/ *Policy and Rules Concerning Rates for Dominant Carriers*, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3256 ¶ 110 (1988).

27/ *See* FNPRM ¶¶ 218, 225.

28/ *See id.* ¶¶ 222, 225.

29/ *See id.* ¶ 227.

common line rate formula.[30] However, the two cases are not analogous; the reasons for adopting the g factor for common line charges simply do not apply in the case of capacity-based switching charges. Indeed, adopting a q factor would run directly contrary to the Commission's professed goal of maximizing the economic rationality of the rate structure.

The Commission adopted the g factor because "carrier common line rates are traffic-sensitive even though common line costs are non-traffic-sensitive."[31] The Commission took the position that, since common line costs are fixed, an increase in per-minute usage per access line would increase CCL revenues without any corresponding increase in costs. In other words, in the Commission's view, additional revenues from growth in usage per line were essentially a pure windfall. The Commission did not believe that LECs should receive the entire benefit of this windfall, so it adopted a g/2 factor to split the windfall evenly between LECs and IXCs.

Whether or not the Commission's rationale for the g factor was sound, switching presents an entirely different case. Unlike common line costs, switching costs are *not* fixed. As demand for switching increases, LECs must expand switching capacity, at significant cost. It is true that these costs are incurred in a "lumpy" fashion; switching capacity is deployed in fairly large blocks, so not every unit of increase in demand results in the deployment of new switching facilities. Nonetheless, it is undeniable that, in the aggregate, increases in demand for switching lead to additional costs.

30/ *See id.* ¶¶ 217-18.

31/ *Id.* ¶ 217.

In proposing a q factor, the FNPRM treats this "lumpiness" as meaning that an incremental increase in the number of trunks ordered by an IXC may, like an increase in common line usage, result in windfall revenues for the LEC. In other words, the proposal assumes that, so long as a switch is not yet at full capacity, the purchase of an additional trunk into that switch poses *zero* additional costs on the LEC.[32/] From an economic standpoint, this is dead wrong. The addition of the new trunk (or more precisely, the additional traffic that trunk represents) uses up a portion of the limited capacity of the switch and hastens the day when, as a result of growth in switching demand, the LEC will need to invest in new switch capacity. In economic terms, the depletion of limited switching capacity is a real cost, even if it does not require an *immediate* cash expenditure. By contrast, additional minutes of usage on a common line do not generate additional incremental costs: Since the common line is a dedicated facility, a customer could use his line a full 24 hours per day without creating any need for additional common line investment.

Moreover, a conclusion that incremental increases in switching traffic do not cause any costs when the switch is not yet filled to capacity necessarily implies that, when the switch finally *is* filled to capacity, the next incremental unit of additional traffic is responsible for the entire cost of deploying new switching capacity. For example, suppose a switch can handle 100 trunks worth of traffic but can be expanded to serve 120. What is the "cause" of the costs of such an expansion? If the addition of a 96th and 97th trunk is not considered to "cause" *any* portion of these costs, then presumably the addition of the 101st trunk must be treated as "causing" the *entire* cost of the expansion. And if this 101st trunk happens to serve local traffic rather than IXC traffic, then, under this skewed view of cost causation, IXC traffic would not be

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32/ *See id.* ¶ 218.

treated as being responsible for *any* of the costs of deploying new switching capacity, even though increases in IXC traffic may have used up a substantial portion of the capacity of the original switch.

A far more realistic view of cost causation in the switching context is that every increase in traffic to the switch carries a cost — the economic cost of the depletion of limited capacity, which translates directly to actual LEC expenditures. Moreover, the timing of those expenditures does *not* lag behind the LEC's cost recovery. To the contrary, "lumpy" switching expenditures typically are incurred *before* the LEC has collected the corresponding cost recovery: A LEC deploys switching capacity in anticipation of future increases in traffic volumes. Thus, switching revenues associated with those future traffic volumes, far from being unmatched to any costs, simply recover the costs that have already been incurred by the LEC in the form of up-front expenditures.

In sum, no q factor is warranted; it is entirely appropriate that every increase in IXC traffic to the switch (which, in a capacity-based rate structure, is measured by trunks purchased) results in additional revenues for the LEC. If the Commission wanted to adjust for the lumpy nature of switch investment, it could make switching charges equally lumpy by imposing zero or very low charges on most incremental trunk purchases and enormous charges on (say) every 100th trunk. This would be an absurd result, but it is more economically rational than the q factor proposal, which would impose zero or very low charges on *all* incremental trunk purchases, essentially eliminating all interstate cost recovery for the "lumpy" costs of investment in switching. The Commission should not adopt a q factor.

B. Any Adjustments to the Traffic-Sensitive or Trunking Basket PCIs To Account for "Erroneously" Omitting a q Factor in the Past Would Further Undermine the Purposes of Price Cap Regulation.

The FNPRM proposes to reinitialize access charges yet again. In 1995, the Commission ordered price cap LECs to recalculate their PCIs as if they had opted for a higher X factor than they actually did.[33/] Again in 1997, the Commission ordered price cap LECs to reinitialize their PCIs as if they had used an even higher X factor.[34/] Now in 1999, the Commission suggests that price cap LECs should reset their traffic-sensitive and trunking basket PCIs as if they had included a q factor from 1991 to the present.[35/] The Commission should reject this proposal.

In the first place, as U S WEST demonstrated in Part III.A above, no q factor is or has ever been warranted. Therefore, the Commission committed no "error" in failing to have a q factor in the past, and accordingly no corrective adjustment is needed.

Furthermore, manipulating the price cap formulas once again to restrict LEC earnings would undermine the very goal of price caps — to encourage incumbent LECs to be more profitable through increasing demand and efficiency while maintaining or lowering costs. Continually adjusting the formulas in a results-oriented manner effectively signals the Commission's lack of commitment to the basic premises of price cap regulation and erodes the

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33/ *See Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, 10 FCC Rcd 8961, 9081 ¶ 274 (1995).

34/ *See Price Cap Performance Review for Local Exchange Carriers*, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642, 16697 ¶ 141, 16714 ¶ 179 (1997).

35/ *See* FNPRM ¶¶ 222, 225.

confidence of incumbent LECs and their investors in the regulatory regime. The Commission should not reinitialize the traffic-sensitive or trunking basket PCIs.

C. The Fraction of g/2 Should Not Be Increased.

The Commission has invited comments on increasing the g factor used to calculate the common line basket PCI from g/2 to some other fraction up to full g.[36/] Increasing g/2 would enlarge the benefit to IXCs of increased minutes of access use and reduce the benefits to price cap LECs. But it is by no means the case that IXCs alone are responsible for the growth in access minutes. U S WEST, for one, has taken significant steps to stimulate demand for access services. Accordingly, the Commission should not increase the g factor.

As explained above, the Commission adopted the g factor in the common line basket PCI to address a perceived mismatch in the way LECs incur common line costs and the way those costs are recovered. LECs are permitted to charge IXCs on a per-minute basis for each minute of access in order to recover some costs of the local loops.[37/] But the costs of local loops do not vary with the amount of traffic they carry. That is, LECs are recovering a non-traffic-sensitive cost with a traffic-sensitive charge. The more access minutes the loops carry, the more the LECs recover. In order to address this perceived mismatch between the way loop costs are incurred and recovered, the Commission instituted a g factor in the common line basket PCI. Rather than assuming that IXCs are responsible for all the increase in access minutes, however, the Commission assumed that IXCs and incumbent LECs are each responsible for part, and ordered g/2 to be subtracted from the common line basket PCI.

36/ *See id.* ¶ 227.

37/ *See* 47 C.F.R. § 69.154.

The FNPRM proposes to increase the fraction of g subtracted from the common line basket PCI. The effect would be to reward IXCs even more for increased demand for access services, on the theory that IXCs contribute to demand growth more than LECs.[38/] But LECs share responsibility for the recent growth in access services. In large part, that growth is due to decreases in access charges, a development that falls squarely within the province of the LECs.[39/] In addition, U S WEST and other LECs promote demand for access services through advertising and marketing efforts aimed at increasing phone use. Some of the calls resulting from such advertising are interexchange calls. Similarly, U S WEST has encouraged the purchase of products that involve the use of interexchange access, such as caller ID, long distance caller alert, voice mail, and three-way calling. The Commission accordingly should not impose any increase in g/2.

IV. THE COMMISSION SHOULD REORGANIZE THE PRICE CAP BASKETS TO PLACE DEDICATED AND SHARED COMPONENTS INTO DISTINCT BASKETS.

The Commission asks whether the price cap baskets should be reorganized.[40/] U S WEST agrees that charges for dedicated and shared services should be separated into distinct baskets, and proposes that three baskets be established: a common line/marketing basket, a transport basket, and a switching basket. Organizing services in this way would simplify the

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[38/] *See* FNPRM ¶ 227; *Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, 10 FCC Rcd 8961, 9078 ¶ 267 (1995).

[39/] LEC access charge cuts may have been driven by regulatory and competitive imperatives, but cuts in IXC retail long distance rates have been driven by competitive imperatives as well. The fact that LEC and IXC price cuts were not driven by pure generosity does not lessen the impact of those actions on stimulating demand growth.

[40/] *See* FNPRM ¶ 234.

price cap process by grouping similar services into the same baskets. Thus, dedicated components should be placed in a basket that recovers costs from the proper customers — end users and IXC customers in case of the common line basket, and primarily IXC customers in case of the transport basket. Shared components, such as switches and common transport, should be recovered in the switching basket. Organizing services in this way would eliminate unnecessary complexity in the basket structure, and thus would greatly simplify the PCI calculations that LECs must perform (and the Commission must review) each time they file tariffs.

The *common line/marketing basket* should include all rate elements in the existing common line and marketing baskets. The revenues in those baskets are already recovered in the same rate elements — the SLC, the PICC, and the CCL charge.[41/] To the extent the Commission continues using the g factor, it should continue to be calculated as it is today — on only the common line portion of the CCL charge.

The *switching basket* should include all rate elements attributable to components from the first point of switching up to (but not including) the line port, where the common line rate elements take over. Any inappropriate pricing in the switching basket would be constrained by separating the basket into these four categories:

- The *local switching category* should include all existing local switching rate elements, the elements associated with call set-up, and common trunk ports.
- The *tandem-switched transport category* should include the tandem switching rate element, tandem switched transmission, and common transport multiplexing.

41/ *See* 47 C.F.R. §§ 69.152 (end user common line charge), 69.153 (PICC), 69.154 (CCL charge), and 69.156 (marketing expenses).

- The *operator services category* should include directory assistance rate elements, busy-line verify and busy-line interrupt, and any operator services sold to IXCs in support of their switched access traffic originated in an incumbent LEC's territory.

- The *database category* should include all rate elements associated with database query functions, except for CCSAC data links. CCSAC data links currently fall in the transport basket, and should remain there.

The *transport basket* should include all special services and all switched access components from the IXC point of presence up to and including the dedicated trunk port. Within this basket there is no need to establish categories because most of these services are already competitive: IXCs increasingly obtain them from incumbent LECs' competitors, so there is no danger that incumbent LECs will underprice some services using subsidies from non-competitive services. If, however, the Commission decides to impose some pricing restraints within this basket, they should be based on the density zones.

Once services are separated into these three baskets, there will be no need for an interexchange basket. For U S WEST, the only remaining rate elements left in the existing interexchange basket after removal of interstate intraLATA toll[42/] are the busy line verify and busy line interrupt services. Busy line verify and busy line interrupt are not retail services, but services sold to IXCs. As such, they appropriately fit into the switching basket in the operator services category, which would include exclusively services sold to IXCs. Any operator service functions currently in the interexchange basket are also sold to IXCs and should be included in the switching basket's operator services category as well.

42/ *See* Order ¶ 56.

V. THE COMMISSION SHOULD EXPEDITE COMPLAINTS CONCERNING EXCESSIVE CLEC ACCESS CHARGES BUT SHOULD NOT PERMIT IXCS TO REFUSE TO DEAL WITH CLECS, AND, IN ANY CASE, SHOULD ENSURE THAT ANY SOLUTION TO THIS PROBLEM DOES NOT PENALIZE INCUMBENT LECS.

U S WEST is sympathetic to the proposition that no carrier should be required to deal with another carrier when the terms of their relationship will result in the first carrier being forced to absorb uncompensated losses. Nevertheless, U S WEST is wary of AT&T's proposal that IXCs be given carte blanche to refuse to deal with particular CLECs — such an outcome would be both disruptive and open the door to anticompetitive behavior by IXCs. Accordingly, U S WEST suggests that the Commission respond to the problem of excessive access charges by CLECs by (1) affirming that IXCs must carry and pay access charges for all interexchange calls originated by their customers, regardless of which CLEC serves the called party, and (2) making clear that the Commission will handle complaints of excessive access charges with expedition and award damages where appropriate.[43/] Whatever course the Commission adopts, however, it should ensure that the problem is not resolved on the backs of incumbent LECs by forcing incumbents to become middlemen in disputes between IXCs and CLECs.

U S WEST agrees with AT&T's basic premise that it should not be left without a remedy when a CLEC's terminating access charges are unjustifiably high. But the Commission should not give IXCs free rein simply to refuse to deal with a CLEC that charges what the IXC deems to be an excessive rate for terminating access. As section 251(a) of the Act makes clear, the public interest is best served if all carriers interconnect — directly or indirectly — with one

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43/ For purposes of these comments, U S WEST assumes that some CLECs do impose excessive access charges. Of course, if the Commission finds that not to be the case, no Commission action will be necessary.

another. In this way, consumers can choose both their local and long distance carriers on the basis of price and other terms, free from the risk that particular carriers will not provide connectivity to particular end users.

Moreover, the problem created by whatever market power CLECs may possess over terminating access rates should not be solved by handing market power over to IXCs. Yet allowing IXCs to refuse to deal with a CLEC would do just that. For example, a CLEC cannot attract customers if it cannot deliver long distance calls from any caller using AT&T. As a result, AT&T could effectively dictate the terminating access rates it will pay, and CLECs would have to acquiesce or be driven from the marketplace. In addition, if an IXC also were acting as a CLEC in a particular market, it would have strong incentives to confer a competitive advantage on itself by refusing to deal with other LECs in that market or doing so only at extremely low rates.

The best way to resolve the competing interests here is for the Commission to make clear that it will treat complaints about excess CLEC terminating access charges with expedition and that, if the complaint proves valid, the Commission will award damages, including true up payments. This system will not result in re-regulation of CLEC access charges or in a flood of new complaints to the Commission. Indeed, the Commission's simple announcement of this policy likely will cause many CLECs to back down from their most unreasonable practices, and the resolution of a few complaints should eliminate any lingering holdouts.

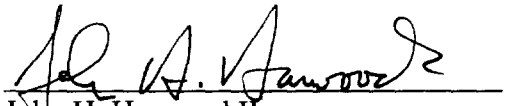
In any event, the Commission should not punish *incumbents* for the CLECs' practices. Two points in particular bear emphasis. *First*, as AT&T concedes, IXCs should not be

permitted to refuse to take terminating access from an incumbent.[44/] Because incumbents' access charges are regulated by the Commission, they are presumptively just and reasonable. If an IXC believes the rates of a particular incumbent are too high, the IXC may seek relief from the Commission. Permitting IXCs to refuse to terminate calls with an incumbent LEC would adversely affect the LEC's customers without serving any public purpose.

Second, even if the Commission permits IXCs to refuse to deal with CLECs in some circumstances, such a cut-off must be implemented without adverse consequences to incumbents. An IXC should not be permitted to hand off all its traffic to the incumbent and leave it to the incumbent to determine whether a particular call is intended for a customer of a CLEC with which the IXC will not deal. An incumbent must be allowed to assume that all traffic an IXC hands off should be terminated, regardless of whether the recipient of the call is a customer of that incumbent or a CLEC. Moreover, in all cases, an incumbent must be compensated for its share of access charges for all calls that an IXC hands off to the incumbent, even if the call is destined for a CLEC with which the IXC refuses to deal.

44/ *See* FNPRM ¶ 243 & n.593.

Respectfully submitted,



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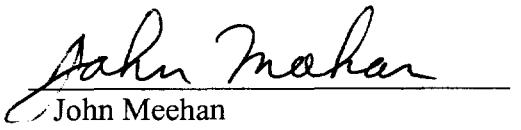
October 29, 1999

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 29th day of October, 1999, I caused true and correct copies of the foregoing Comments of U S WEST, Inc. to be served by hand upon the following parties:



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